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No. 92-665

In the Supreme Court of the United States

OCTOBER TERM, 1992

DAN O. DAVIS, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether a corporate president charged with the responsibility under Section 6672 of the Internal Revenue Code of collecting, accounting for and paying over to the United States income and social security taxes withheld from the wages of the corporation's employees is personally liable for the corporation's unpaid employment taxes when, after becoming aware of the corporation's employment tax delinquency, he continues to disburse funds from the company's accounts to satisfy the claims of other creditors.

2. Whether the Internal Revenue Service properly applied amounts paid by the corporation to the corporation's employment tax liabilities.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-27a) is reported at 961 F.2d 867. The opinion of the district court (Pet. App. 30a-33a) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on April 14, 1992. The petition for rehearing was denied on July 15, 1992. Pet. App. 28a. The petition for a writ of certiorari was filed on October 13, 1992. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Petitioner organized ITAC Corporation and was its president, a member of its board of directors, and its major shareholder (Pet. App. 5a). ITAC failed to make timely payments to the United States of the income and social security taxes that it withheld from its employees' wages (the trust fund tax liability) for the fourth quarter of 1981 and the first and second quarters of 1982 (*ibid.*). ITAC also failed to pay over the employer's share of the social security taxes (the non-trust fund tax liability) (*id.* at 5a-6a). When ITAC thereafter made installment payments on the delinquent amounts, it did not designate the quarter or the liability to which the payments were to be applied (*id.* at 5a).

The Internal Revenue Service initially elected to allocate these payments to ITAC's 1981 trust fund tax liability (Pet. App. 6a). When the Service learned that there were no corporate assets available to satisfy ITAC's non-trust fund tax liability, however, the Service then reallocated ITAC's payments from the 1981 trust fund tax debt to the non-trust fund tax liabilities (*ibid.*). In this manner, the Service sought to enhance the government's ability to collect the full amount of the unpaid taxes (*ibid.*).

On December 3, 1985, the Service assessed against petitioner a "penalty" under Section 6672 of the Internal Revenue Code, 26 U.S.C. 6672, in an amount equal to the taxes that had been withheld from ITAC's employees' wages that had not been paid over to the government (the trust fund taxes) for the fourth quarter of 1981 and the first and second quarters of 1982 ($69,791.32) (Pet. App. 6a; Gov't C.A.

Br. 3). The Service determined that petitioner was a person responsible for seeing that ITAC paid over its withholding taxes to the government for the quarters assessed and that he willfully failed to do so (*ibid.*).

2. Petitioner paid part of the amount assessed against him under Section 6672 and sued for a refund (Pet. App. 6a). The United States counterclaimed against petitioner for the remaining amount assessed under Section 6672, plus interest and fees (*ibid.*).

At trial, petitioner maintained that he did not know of the corporation's failure to pay the taxes to the government until after the tax return was due and the withheld funds had been dissipated (Pet. App. 6a). Petitioner conceded, however, that, after learning of the unpaid tax liabilities, he made payments to commercial creditors, rather than to the government, using funds acquired by ITAC after the withheld funds had been dissipated (*ibid.*). These payments exceeded the amount of the taxes due (*ibid.*). Petitioner claimed, however, that, under *Slodov* v. *United States*, 436 U.S. 238 (1978), the jury should be instructed that, if a responsible officer does not learn of the corporation's tax delinquency until after the return for a particular quarter is due, he has not "willfully" failed to pay over the taxes even though he uses funds acquired after the withholding obligation becomes due to pay other creditors (Pet. App. 6a). The court disagreed with petitioner's interpretation of *Slodov* and refused to give the proposed jury instructions (*ibid.*). The court instead instructed the jury that petitioner could not, with knowledge of the unpaid taxes, use after-acquired funds to pay other creditors (*id.* at 6a-7a).

Following trial, the jury found that petitioner was a responsible person who had willfully failed to collect, account for, and pay over the withholding taxes of ITAC for each of the quarters in issue (Pet. App. 7a). The penalty assessment against petitioner under Section 6672 was therefore upheld.

3. On March 7, 1990, petitioner filed a post-trial motion seeking to reduce the assessment for the fourth quarter of 1981 (Pet. App. 7a). Petitioner argued that the Service could not reallocate the payments initially allocated to the non-trust fund taxes due for the fourth quarter of 1981 to ITAC's trust fund tax liability (*ibid.*). Alternatively, petitioner claimed that no effective application of the payments had occurred because the Service did not notify him of the manner of application. Petitioner therefore asserted that the payments must be applied to the earliest debts first—to the trust-fund liability for the fourth quarter of 1981 (*ibid.*).

The district court denied petitioner's motion (Pet. App. 29a) and entered judgment against petitioner in accordance with the jury's verdict.

4. The court of appeals affirmed (Pet. App. 1a-27a). On appeal, petitioner did not contest the determination that he was a "responsible person" during the three quarters in issue (*id.* at 7a-8a). Petitioner claimed instead that, as a matter of law, he did not act willfully, as Section 6672 requires (Pet. App. 8a). The court of appeals rejected that contention. The court held that petitioner's deliberate decision after he became aware of the withholding tax delinquency to use corporate funds to pay commercial creditors, rather than to pay the corporate tax debt, constituted

a willful failure to pay the taxes owed (*id.* at 8a-9a). Such payments represented a "voluntary, conscious and intentional act to prefer other creditors over the United States" (*id.* at 9a, quoting *Klotz* v. *United States*, 602 F.2d 920, 923 (9th Cir. 1979)). The court of appeals held that this Court's decision in *Slodov* is not applicable to the situation this case presents, where the persons who were responsible for the failure to collect and pay the withholding taxes in the *first* instance (as opposed to new management) used after-acquired corporate funds to pay the claims of other creditors (Pet. App. 11a).

The court of appeals also upheld the district court's decision not to reduce the Section 6672 penalty by the amount of the tax payments the Service initially allocated to the corporation's non-trust fund tax liability. The court adopted and applied the settled rule that, when a taxpayer fails to specify that funds must be applied to a specific tax liability, the Service may apply the payment in any manner it chooses (Pet. App. 24a). The court also noted that petitioner had failed to demonstrate that he had suffered any detrimental reliance from the Service's allocation of these payments (*id.* at 26a-27a).

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or any other court of appeals. Further review is therefore not warranted.

1. Under Section 6672(a) of the Code, when a person responsible "to collect, truthfully account for, and pay over" withholding taxes "willfully" fails to do so, he is liable for a "penalty" equal to the amount of

the unpaid taxes. 26 U.S.C. 6672(a). Petitioner did not contest the jury's finding that he was "responsible" for collecting and paying over withheld taxes during the periods at issue in this case. As the court of appeals correctly concluded (Pet. App. 9a), a responsible person "willfully" fails to pay over withholding taxes when he permits the corporation's funds to be paid to other creditors with knowledge that the withholding taxes have not been paid over to the government. Petitioner's deliberate decision to use corporate revenues to pay commercial creditors, rather than to pay the corporation's withholding tax debt, constituted a "willful" failure to pay those taxes under the consistent decisions of the courts of appeals. See, *e.g.*, *Honey* v. *United States*, 963 F.2d 1083, 1087-1089 (8th Cir. 1992), cert. denied, No. 92-460 (Dec. 7, 1992); *Smith* v. *United States*, 894 F.2d 1549, 1553-1554 (11th Cir. 1990); *United States* v. *Vespe*, 868 F.2d 1328, 1335 (3d Cir. 1989); *Thibodeau* v. *United States*, 828 F.2d 1499, 1505-1506 (11th Cir. 1987); *Wood* v. *United States*, 808 F.2d 411, 415-416 (5th Cir. 1987); *Garsky* v. *United States*, 600 F.2d 86, 90-91 (7th Cir. 1979); *Maggy* v. *United States*, 560 F.2d 1372, 1375-1376 (9th Cir. 1977); *Kizzier* v. *United States*, 598 F.2d 1128, 1133-1134 (8th Cir. 1979); *Mazo* v. *United States*, 591 F.2d 1151, 1157 (5th Cir.), cert. denied, 444 U.S. 842 (1979); *Teel* v. *United States*, 529 F.2d 903, 905 (9th Cir. 1976).[1]

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[1] Willfulness may also be established by a reckless disregard of the obligation to make withholding tax payments. *Wood* v. *United States*, 808 F.2d 411, 415 (5th Cir. 1987) (a responsible person acts willfully by proceeding with a "reckless disregard of a known or obvious risk that trust funds may not be remitted

2. There is no merit to petitioner's contention (Pet. 7-8) that these consistent decisions of the courts of appeals conflict with this Court's decision in *Slodov* v. *United States*, *supra*. In *Slodov*, the Court addressed the situation of an individual who becomes responsible for a corporation's withholding taxes *after* prior management (i) has used the funds represented by those taxes to pay other creditors and (ii) has left the corporation with no unencumbered funds with which to pay the taxes owed to the United States. In these circumstances, the Court held that the newly responsible individual is obligated to use funds that subsequently come into the corporation's possession to satisfy the prior tax delinquency only when the after-acquired funds are directly traceable to the dissipated trust fund taxes. 436 U.S. at 259-260.

Unlike the situation in *Slodov*, petitioner was at all times responsible for collecting and paying over the corporation's trust fund taxes. He was therefore under a continuing duty to apply all unencumbered funds received by the corporation to satisfy the withholding tax obligations. His failure to do so constituted a willful failure to carry out his duties to the United States, thereby making him liable for the unpaid taxes under Section 6672. Nothing in *Slodov* supports petitioner's claim that an individual who *is* a responsible person when the withholding tax obligation accrued has no duty to use funds acquired by the corporation afterwards to satisfy the unpaid tax

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to the government"); *Mazo* v. *United States*, 591 F.2d at 1154. The district court so instructed the jury (Tr. 15-16), and the jury's verdict may well have rested on a factual determination that petitioner acted with such reckless disregard.

liability. As the Seventh Circuit stated in *Garsky* v. *United States*, 600 F.2d at 91:

> *Slodov* does not relieve a "responsible person" of the responsiblity to reduce accrued withholding tax liability with funds acquired after the funds actually withheld have been dissipated so long as the person responsible has been so throughout the period the withholding tax liability accrued and thereafter.

Accord, *e.g.*, *Honey* v. *United States*, 963 F.2d at 1088-1089; *Kizzier* v. *United States*, 598 F.2d at 1134; *Mazo* v. *United States*, 591 F.2d at 1154.

3. Petitioner errs in contending (Pet. 10-11) that the court of appeals confused the concepts of responsibility and willfulness. The court of appeals observed that petitioner was a "responsible person" before, during, and after the withheld taxes were dissipated to satisfy corporate needs, and that he at all times had the authority and responsibility to prevent this breach of trust, but failed to do so. The separate element of willfulness was established by petitioner's deliberate decision to prefer other creditors to the United States once he was aware of the outstanding withholding tax liability (Pet. App. 12a-15a). Petitioner's "actions after he learned of the tax debt are what constituted willfulness" (*id.* at 18a).

4. Petitioner contends (Pet. 11-15) that the tax collection objective that underlies Section 6672 will not be served by imposing liability on corporate managers who unsuccessfully undertake rehabilitation after they first learn of unpaid employment taxes. That contention, with which we disagree, should be addressed to Congress, not to the courts.

In any event, as the court of appeals pointed out, under the "penalty" provisions of Section 6672, "[e]xisting management has a vested interest, financial and otherwise, in guiding a business through troubled waters. Legal obligations and duties limit an officer's ability to walk away upon learning of an overdue tax liability" (Pet. App. 14a). Section 6672 imposes continuing payment obligations on responsible persons precisely so that corporate officers cannot frustrate their payment obligations simply by rotating their corporate responsibilities. Congress did not intend to leave the collection of withholding tax payments to an evasive scheme of official "corporate roulette" (Pet. App. 14a).

5. The court of appeals correctly upheld the district court's refusal to reduce the 1981 assessment for unpaid trust fund taxes.[2] It is undisputed that ITAC had not designated any of its late payments toward any particular portion of its outstanding tax liability. In the absence of such a designation by the taxpayer, it is well established that the Service may

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[2] Petitioner contends (Pet. 16) that the court of appeals erroneously characterized his appeal on this issue as an appeal from the denial of mandamus and erroneously restricted review to an abuse of discretion standard, instead of applying a *de novo* review. Petitioner has not shown that there is any conflict in the federal courts of appeals regarding the standard of review on this issue. Moreover, the court of appeals not only determined that there was no basis for reversing the district court's decision, but further indicated three significant problems with petitioner's position, detailing why petitioner was not entitled to the relief he had requested. It is thus evident that the decision in this case would have been the same even if a *de novo* standard of review had been applied.

apply any voluntary payment it receives to any outstanding tax liability of the taxpayer. *Muntwyler* v. *United States*, 703 F.2d 1030, 1032 (7th Cir. 1983); *Liddon* v. *United States*, 448 F.2d 509, 513 (5th Cir. 1971), cert. denied, 406 U.S. 918 (1972); Rev. Rul. 79-284, 1979-2 C.B. 83; Policy Statement P-5-60, [1 Administration] Internal Revenue Manual (CCH) at 1305-14 (approved May 30, 1984); cf. *United States* v. *Energy Resources Co.*, 495 U.S. 545 (1990).[3] The court of appeals agreed that the Service was justified in its ultimate allocation of the late payments in this case, noting that "straitjacketing the [Service] into its initial allocation decisions would be inconsistent with the goal of maximizing tax revenues" (Pet. App. 25a). The court also correctly observed (*id.* at 26a) that petitioner had failed to establish that he had relied to his detriment in any manner on the initial allocation.

Petitioner also errs in contending (Pet. 20-24) that the decision in this case conflicts with the court of appeals' prior decision in *Brookhurst, Inc.* v. *United States*, 931 F.2d 554 (9th Cir.), cert. denied, 112 S. Ct. 299 (1991). *Brookhurst* did not address the effect of a reallocation of an employment tax payment. It involved the Service's ability to reassess a liability

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[3] Petitioner contends (Pet. 18-19) that the Service never in fact reallocated the late payments because the reallocation is not reflected in the Certificate of Assessments and Payments. This factual contention was decided adversely to petitioner in the district court. That determination was not clearly erroneous, for the Form 4183, 100-Percent Penalty Data, submitted into evidence by the government (CR 25, Exh. 1 at 4) clearly shows the reallocation of the payments.

that was concededly no longer subject to assessment. As the court of appeals indicated in distinguishing *Brookhurst* in its decision in this case (Pet. App. 25a n.4), that issue is not involved here. Moreover, even if an intra-circuit conflict existed, that would afford no basis for further review in this Court.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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